Regional Energy

Upstream & Integrated Oils

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DBS Group Research . Equity

9 Mar 2021

What if oil hits US$80 or higher?

- **Brent crude oil prices have already breached US$70/bbl and show little signs of fatigue**
- **Oil plays are looking at much improved earnings in FY21/22, but share prices are still below their 2020 highs despite the better outlook**
- **If the oil price rally continues, earnings upgrades could range from 30-60% at US$80 oil price and even double at the US$100 mark**
- **CNOOC is the most leveraged to oil price upside**

Forecasts revised up again. With a stronger than expected start to the year, we are raising (again) our average 2021 Brent crude oil price forecast to USD60-65/bbl. Demand recovery in 2021 (of around 5.5mmbpd by our projections) should outpace supply growth significantly (increasing by only around 2.0mmbpd by our projections, curtailed by OPEC+ cuts), leading to continued global inventory drawdowns, supporting oil prices. Our 2022 average Brent crude oil forecast stands at USD62-67/bbl on the assumption that air travel recovers closer to normal levels in 2022, OPEC+ discipline stays, and US shale production growth is contained. Looking further ahead, we believe there could be potential risk of oil price spikes towards USD80/bbl or higher in future, once demand has recovered to pre-COVID levels and OPEC spare capacity is down to normalised levels, as severe systemic underinvestment on the upstream side in recent years could have an impact on non-OPEC supply growth in future.

Oil proxies remain in favour. While O&G names have had a good run, stock prices are still lower than 2020 highs despite a rosier oil price outlook. CNOOC was especially hit by a selloff on stocks in the US military blacklist. Our top picks for oil proxies are CNOOC, PTT and Medco.

Significant upside if oil rally continues. We have raised our earnings forecasts and TPs for upstream names to factor in the higher oil price assumptions for 2021/22 and higher long-term oil price of US$60/bbl (vs US$55/bbl previously). Our sensitivity analysis suggests that in the event of oil price surging towards US$70-80/bbl, earnings upgrades of 30-60% could be possible and at US$100/bbl (unlikely), we could see pure upstream companies' earnings doubling from current estimates. This would then imply significant valuation upside from current levels.

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STOCKS

	Price LCY	Mkt Cap US$m	12-mth Target Price HK$	Performance (%) 3 mth	12 mth	Rating
CNOOC	9.50	54,636	15.00	32.5	(10.6)	BUY
China Petroleum & Chem (Sinopec)	4.44	14,592	5.20	24.4	13.0	BUY
PetroChina	3.05	8,289	4.40	27.1	1.3	BUY
PTT Exploration & Production	119	15,476	145	17.2	11.7	BUY
PTT	42.00	39,299	50.00	(2.3)	12.0	BUY
Thai Oil PCL	64.25	4,294	67.00	23.6	53.9	BUY
Medco Energi Internasional TBK	670	1,178	770	18.6	0.8	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 8 Mar 2021

Target price revisions

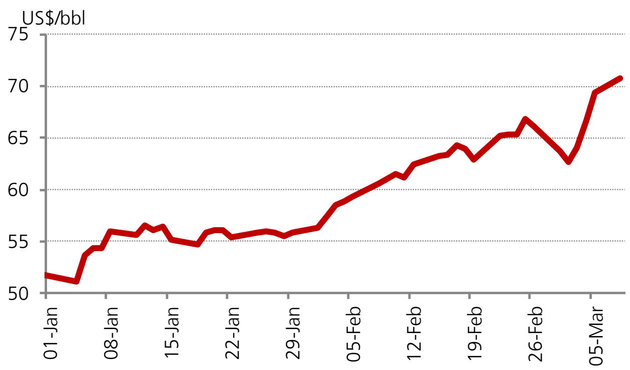
Company	Target Price Old	New	Upside
CNOOC	HKD 12.00	HKD 15.00	61%
Petrochina	HKD 4.00	HKD 4.40	50%
Sinopec	HKD 4.80	HKD 5.20	19%
Medco	Rp770	Rp770	18%
PTTEP	Bt125	THB 145	25%
PTT	Bt50	Bt50	23%

Source: DBS Bank

Bullish trends continue for oil. Brent crude oil prices are touching USD70/bbl as we write, with the latest boost from purported attacks on Saudi oil facilities by Yemeni forces. This has been a much faster recovery than we had initially expected. Having started the year at USD52/bbl, the rally has gone from strength to strength in the first two months of 2021. A series of beneficial news flows have provided significant momentum to oil bulls, including the recent OPEC+ decision to defer production increases by another month in the March 2021 ministerial meeting. Saudi Arabia has proposed to continue its voluntarily production cut of 1.0mmbpd from January levels through to April.

This follows the cold freeze in Texas since mid-February, which has taken off c.4mmbpd of Permian shale oil production for a couple of weeks at least and could take some time before normalcy is restored. The recent US FDA approval of Johnson & Johnson's single shot COVID-19 vaccine has also boosted sentiment. US crude oil inventories also showed supportive trends in early 2021, with higher-than-expected drawdowns of 24mmbbls over the first six weeks, which is slightly counter-seasonal. Coupled with vaccine rollout optimism and hopes of further US fiscal stimulus measures, oil prices appear relatively well supported for the foreseeable future.

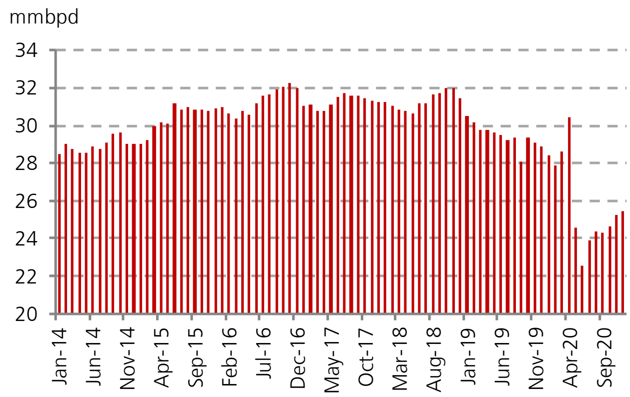
Brent crude oil price trajectory YTD in 2021



Source: US Energy Information Administration (EIA), DBS Bank

OPEC+ production increase does not materialise in April, oil price soars. In the most recent OPEC+ ministerial meeting in early March 2021, contrary to popular expectations, Saudi Arabia chose to continue its 1mmbpd voluntary production cuts for another month, into April 2021, and there was no change in production quotas for other OPEC members either. Non-OPEC allies Russia and Kazakhstan received some leeway, in the form of a combined 150,000bpd (0.15mmbpd) increase, which is far lower than the 0.5mmbpd increase expected by the market. So, instead of 1.5mmbpd+ increase in OPEC+ production expected from April, it is less than 0.2mmbpd and effectively, the increase in production has been deferred for another month. OPEC+ oil ministers will meet again on 1 April 2021 and review the existing arrangements.

OPEC production trends

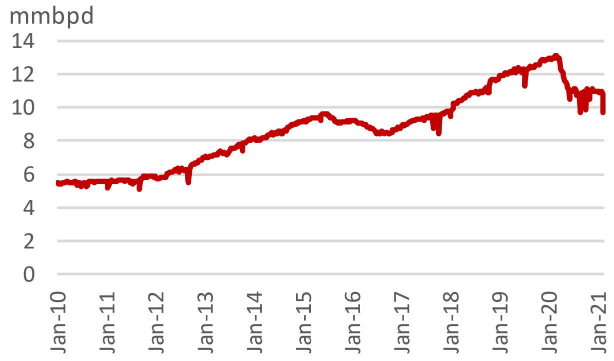


Source: Bloomberg Finance L.P., DBS Bank

The market was already tight, following the cold snap in Texas. Oil prices were already climbing steadily since the start of February on the back of inventory drawdowns in the US, fall in global infection numbers and approval of more vaccines in the US. This was exacerbated by the unusual snow storms in Texas middle of last month, which led to disruptions in drilling and fracking operations in the Permian Basin, the most prolific shale oil producing area in the US. Around 3-4mmbpd of US oil production is estimated to have been affected in the last couple of weeks and it could take a while for operations in the Permian Basin to normalise. US shale production had already fallen from pre-COVID levels of 13mmbpd to 11mmbpd before the Texas snow storms, and US production in 2021 could now be slower than previously expected, thus boosting oil market sentiments further.

Even tighter following Canada outage. According to Bloomberg reports, maintenance at three oil sands upgraders in Canada will take off some 500,000 bpd (0.5mmbpd) offline, helping tighten supply further amid the ongoing oil price rally. The oil sands cut will be temporary but even when the three companies resume operations at their upgraders, there is unlikely to be too much growth in production from Canadian oil sands, as it appears emission reduction is a bigger priority for oil sands operators than production growth in the current circumstances.

US weekly oil production trends



Source: US Energy Information Administration (EIA), DBS Bank

Upper end of our existing forecast range breached comfortably for now. We were earlier forecasting Brent to average between US$55-60/bbl in 2021, with 1Q21 averaging at US$53.5/bbl. With this stronger than expected start to the year, 1Q21 average could now be in the range of US$60-65/bbl, and we are thus raising our forecast for the full year as well, after considering revisions to our supply side model from the above factors. Brent crude oil prices averaged around USD43/bbl in 2020. We are likely to see a much better year for oil in 2021, as demand recovers (by around 5.5mmbpd by our projections, after falling by around 9mmbpd in 2020), while supply remains curtailed by OPEC+ production cut agreements (increasing by only around 2.0mmbpd by our projections, much less than the demand increase). This will lead to inventory drawdowns and stronger oil prices overall.

We revise up our forecasts. With a stronger start to the year, we are raising our average 2021 Brent crude oil price forecast to USD60-65/bbl. Our 2022 average Brent crude oil forecast stands at USD62-67/bbl on the assumption that air travel recovers closer to normal levels in 2022, OPEC+ discipline stays, and US shale production growth is contained. Looking further ahead, we believe there could be potential risk of oil price spikes towards USD80/bbl or higher in future, once demand has recovered to pre-COVID levels and OPEC spare capacity is down to normalised levels, as severe systemic underinvestment on the upstream side in recent years could have an impact on non-OPEC supply growth. In the longer term, oil demand will no doubt be affected by rise of electric vehicles and transition to cleaner energy. This will have an impact on downstream businesses including refining and oil services, where supply glut is more difficult to control. However, supply side discipline in the upstream sector should continue to support oil prices in our view. OPEC's recent track record gives us more confidence. Thus, we revise our long-term Brent crude oil price assumption to US$60-65/bbl from US$55-60/bbl.

At current toppish levels, there are risks to the downside, no doubt, but the bulls have it for now. After falling continuously for the first 6-7 weeks of 2021, US crude oil inventory data showed record inventory builds of 21.6mmbbls for last week, likely because of outages in refining operations in Texas, but that was ignored by the market. So, unless bad news is really "bad", oil market sentiment will unlikely turn too much in the near term.

Brent crude oil price – DBS Bank's view

(US$ per barrel)	2015	2016	2017	2018	2019	2020	2021F	2022F
Average Brent crude oil price	54	45	55	72	64	43	60-65	62-67
Long-term Brent crude oil price								60-65

Source: DBS Bank forecasts

Revised quarterly oil price forecast – DBS Bank

(US$ per barrel)	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Average Brent crude oil price	62.0	63.0	62.0	64.0	64.5	65.5	66.5	67.5
Average WTI crude oil price	59.0	60.0	59.0	61.0	61.5	62.5	63.5	64.5

Source: DBS Bank forecasts

Buy the oil proxies. Upstream companies are the best proxies to ride on the oil price momentum, in particular the Chinese names which have underperformed regional peers despite an earlier and firmer recovery from COVID. Share prices of upstream players are also below 1Q20 levels (2020 highs), even though we are seeing firmer oil prices. We thus believe there are more legs to the share price rally in view of oil price optimism. Our top picks are CNOOC, PTT and Medco.

Share price of upstream players remain lower than 1Q20 levels despite firmer oil prices, in particular Chinese players

Company	Share price (LC)			P/Bv			Current share price vs:	
	2020 High	2020 Low	Current	2020 High	2020 Low	Current	2020 High	2020 Low
Date	Jan-20	Mar-20	Mar-21	Jan-20	Mar-20	Mar-21		
Upstream/Integrateds								
CNOOC	13.34	6.40	9.31	1.2	0.6	0.8	-30%	45%
Petrochina	3.82	2.23	2.93	0.5	0.3	0.4	-23%	31%
Sinopec	4.57	3.20	4.38	0.7	0.5	0.7	-4%	37%
Medco	640	312	655	0.7	0.4	0.7	2%	110%
PTT	46.5	25.75	40.5	1.5	0.8	1.3	-13%	57%
PTTEP	131.5	55	116	1.5	1.3	1.3	-12%	111%

Source: Company, Bloomberg, DBS Bank

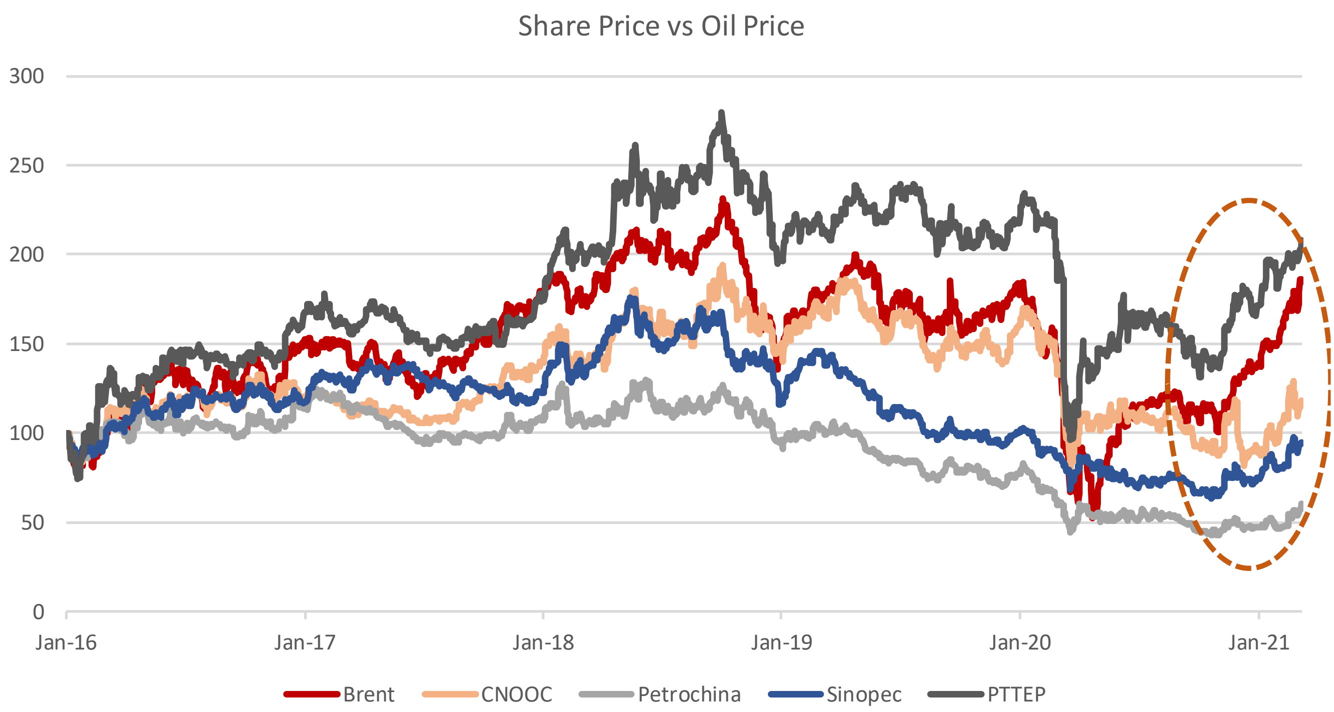
Preferred oil proxies under our coverage

Stock Picks Rec, TP (% upside)	Investment Thesis
CNOOC BUY, HKD15 (+61%)	**Best proxy** to ride oil price as a pure offshore upstream play (80% crude oil; 20% natural gas) Staying ahead of peers with world class cost control; **all in cost further reduced to ~US$25/bbl** in 2020 Current share price only reflects **~US$50/bbl oil price** Expect decent **4-5% dividend yield** for FY2020-22
PTT BUY, THB50 (+23%)	**A diversified and defensive energy company** whose consolidated EBITDA is proportionately contributed by the upstream, downstream and gas businesses Our positive stance on PTT: i) direct beneficiary of rising oil prices, ii) improving power demand with declining pooled gas cost in 2021F, and iii) expectations of a strong gas business with higher sales volume, lower pooled gas cost and higher chemical prices.
Medco BUY, Rp 770 (+18%)	**Earnings recovery potential on better crude oil price trend** - US$10 per bbl upswing in Brent oil price could lift its EBITDA by US$100m-110m Firmer operating cash flow increases MEDC's financial flexibility either to accelerate debt repayment or pursue inorganic growth opportunities Current market capitalization of US$1bn **implies 40% discount to MEDC's estimated Net Asset Value (NAV) of US$1.7bn**

Source: Company, DBS Bank

Share prices have lagged oil price performance, especially CNOOC. While oil prices have staged a strong rally since early 2021, stock prices especially of the Chinese oil majors have not fairly reflected the strong rebound, as illustrated in the chart below. It is worth noting that CNOOC's share price, which is 0.9x correlated to oil prices, saw this correlation breakdown in end 2020 due largely to US military blacklist inclusion. We expect the share price to catch up with the overhang now behind us.

Share prices of upstream companies mostly still lagged oil price performance



**Indexed to 1-Jan-2016 where oil price was ~US$37/bbl, near last cycle's trough oil price of US$27.88 on 20-Jan-2016*
Source: Company, Bloomberg Finance L.P., DBS Bank

Lifting the earnings bar and TPs. We have lifted our forecasts for E&P companies under our coverage. incorporating higher average Brent of US$60-65/bbl for 2021, US$62-67/bbl for 2022 and long-term oil prices of US$60-65/bbl (from US$55-60/bbl previously). The TPs of oil plays under coverage are also lifted accordingly, as shown in the chart alongside.

Target price revisions

Company	Target Price		
	Old	New	Upside
CNOOC	HKD 12.00	HKD 15.00	61%
Petrochina	HKD 4.00	HKD 4.40	50%
Sinopec	HKD 4.80	HKD 5.20	19%
Medco	Rp770	Rp770	18%
PTTEP	Bt125	THB 145	25%
PTT	Bt50	Bt50	23%

Source: DBS Bank

And what happens if optimism refuses to fade? While we believe US$70/bbl levels may not be sustainable for the full year and base our current FY21 earnings forecasts on a more conservative US$60/bbl average Brent crude oil assumption, we do note that the oil market tends to surprise more often than not. So, a little sensitivity analysis never hurts. The table below thus illustrates the earnings sensitivity to Brent crude oil prices at US$70/bbl, US$80/bbl and US$100/bbl averages for FY21. As evident below, CNOOC is the most leveraged amongst all due to its pure upstream business with highest crude leverage of c.80%. PTTEP is also similarly leveraged to crude oil prices. On the question of potential upside to our TPs, we reckon share prices usually track spot prices, but our TPs also incorporate long-term oil prices for DCF based valuations. Hence, the leverage to long term oil price assumption upgrades of US$5/bbl are shown below as representative of share price sensitivity to oil prices. Again, no surprise that CNOOC's target price is the most sensitive to changes in our oil price assumptions.

Scenario analysis: CY21 earnings sensitivity to oil price at US$70, US$80 and US$100/bbl

Company	CY21F Net Profit						
	Current	At US$70/bbl	Chg	At US$80/bbl	Chg	At US$100/bbl	Chg
CNOOC	7,525	10,091	34%	12,432	65%	15,464	106%
Petrochina	6,865	9,172	34%	11,172	63%	13,018	90%
Sinopec	7,508	8,277	10%	8,892	18%	10,585	41%
Medco	114	120	5%	150	32%	163	43%
PTTEP	964	1,328	38%	1,625	69%	2,126	121%
PTT	2,805	3,123	0.114	3,249	16%	3,588	28%

Source: Company, Bloomberg Finance L.P., DBS Bank

Target price sensitivity to long-term oil price:

Oil Price (US$/bbl)	35	40	45	50	55	60	65
CNOOC (HKD)	4.20	5.60	7.40	10.00	12.00	15.00	18.00
Upside to current share price	*-55%*	*-40%*	*-21%*	*7%*	*29%*	*61%*	*93%*
PTTEP (THB)	99	108	117	127	136	145	155
Upside to current share price	*-15%*	*-7%*	*1%*	*9%*	*18%*	*26%*	*34%*
Medco (Rp)	508	574	639	705	770	835	901
Upside to current share price	*-22%*	*-12%*	*-2%*	*8%*	*18%*	*28%*	*38%*

Source: Company, DBS Bank

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BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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